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AUTHORITIES CITED

In the Supreme Court of the United States

RAY CONSOLIDATED COPPER COMPANY, a corporation, appellant
v.
THE UNITED STATES OF AMERICA

No. 443

ON APPEAL FROM THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

STATEMENT

The appellant brought action in the Court of Claims to recover a capital stock tax alleged to have been illegally assessed and collected under the Revenue Act of 1918. The case was considered upon an amended petition and an agreed statement of facts. The Court of Claims dismissed the petition. The company thereupon appealed to this court.

Section 1000 of the Revenue Act of 1918, 40 Stat. 1057, 1126, under which the tax was laid, provides:

> Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair

> average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of the capital stock the surplus and undivided profits shall be included.

The company contended that the fair average value of its capital stock for the preceding year should be computed by multiplying the total number of shares of its capital stock by the average price which dealers upon the New York Stock Exchange paid for its shares during the preceding year. It made a payment of taxes upon that basis.

The Commissioner of Internal Revenue declined to accept the company's contention and assessed and collected the tax upon the basis of the net assets of the corporation. He subsequently modified the computation as originally made, giving more weight to depreciation, and granted a refund of a portion of the amount collected. There is now no question as to the accuracy of his computation if, as the Government submits, the statute lays a tax based upon the fair average value of the net assets of the corporation itself rather than upon the average market value of the shares of stock, which are not owned by the corporation but by its stockholders.

ARGUMENT

I

The tax is imposed on the privilege of carrying on or doing business in a corporate capacity and is measured by the fair average value of the corporation's capital stock. In the estimate of the value of the capital stock there should be included every factor giving value to the privilege upon which the tax is imposed.

The capital stock tax imposed by the section of the Revenue Act of 1918 involved in this case is a special excise tax with respect to the "carrying on or doing business." The section provides:

(1) "Every domestic corporation" shall pay

(2) "A special excise tax with respect to carrying on or doing business" measured by

(3) "The fair average value of *its* capital stock for the preceding year."

(4) "In estimating the value of capital stock the surplus and undivided profits shall be included."

It will be first noted that the tax is one for the privilege of doing business on the part of the corporation. It is thus an excise tax (as is plainly stated in the Act) and is *not* a tax upon the shares of stock in the hands of the shareholders, nor is it a tax upon the property of the corporation, but an excise tax upon the *corporation* for the privilege of doing business. As pointed out in *Central Union Trust Co.* v. *Edwards*, 282 Fed. 1008, 1009:

> The tax imposed by the statute is not a property tax. It is an excise imposed

> upon the privilege of doing business in corporate form, as a going concern. The value of this privilege is the obvious way to measure the tax.

To the same effect are *Washington Water Power Co.* v. *United States*, 56 Ct. Claims 76; *National Paper & Type Co.* v. *Edwards*, 292 Fed. 635.

Any reasonable measure of the value of the privilege may be used by Congress as a basis for the computation of the tax. Under the Corporation Excise Tax Act of 1909, the measure used was the net income of the corporation. Although the Sixteenth Amendment had not been adopted at that time, this court held in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, that income was not being taxed, but was only used as a measure of a tax upon the privilege of carrying on business in a corporate capacity, and concluded that net income was a reasonable measure of such privilege. The court said (pp. 165, 166):

> Conceding the power of Congress to tax the business activities of private corporations, including, as in this case, the privilege of carrying on business in a corporate capacity, the tax must be measured by some standard, and none can be chosen which will operate with absolute justice and equity upon all corporations. Some corporations do a large business upon a small amount of capital; others with a small business may have a large capital. A tax upon the amount of business done might operate as unequally as a measure of excise as it is

> alleged the measure of income from all sources does. Nor can it be justly said that investments have no real relation to the business transacted by a corporation. The possession of large assets is a business advantage of great value; it may give credit which will result in more economical business methods; it may give a standing which shall facilitate purchases; it may enable the corporation to enlarge the field of its activities and in many ways give it business standing and prestige.

On October 22, 1914, Congress enacted "An Act to increase the internal revenue," etc. (38 Stat. 745). Section 3 (p. 750) imposed a tax on the *privilege of carrying on a banking business.* Its terms pertinent to this inquiry were as follows:

> SEC. 3. That on and after November first, nineteen hundred and fourteen, special taxes shall be, and hereby are, imposed annually as follows, that is to say:
>
> First. Bankers shall pay $1 for each $1,000 of *capital used or employed,* and in *estimating* capital surplus *and undivided profits shall be included.* The amount of such annual tax shall in all cases be computed on the basis of the *capital, surplus, and undivided profits for the preceding fiscal year.* [Italics ours.]

Thus we find Congress abandoning net income as the measurement of an excise tax and adopting a more comprehensive standard; that is, "capital used or employed."

The Bankers Tax Act above was the forerunner of section 407 of the Revenue Act of 1916. In drafting the revenue bill of 1916 the House of Representatives retained the tax on bankers in substantially the same terms as had theretofore appeared in the Act of October 22, 1914. When the bill reached the Senate it was amended to extend to and include *all corporations,* and the measure of the tax was made substantially the same as in the Act of 1914 on bankers. The Senate amendment, in so far as pertinent to this inquiry, provided as follows:

> Corporations, * * * shall pay 50 cents for each $1,000 of capital stock, surplus, and undivided profits used in any of the activities or functions of their business, including such sums of capital stock, surplus, and undivided profits as may be invested in or loaned upon stock, bonds, mortgages, real estate, or other securities. The amount of such annual tax shall in all cases be computed on the basis of the capital, surplus, and undivided profits for the preceding fiscal year * * *.
>
> (See Senate Committee print, H. R. 16763, 64th Congress, 1st session, p. 99; conference committee print, H. R. 16763, 64th Congress, 1st session, p. 122.)

This amendment was not concurred in by the House managers in so far as the measure of the tax was concerned. To that extent it was amended so as to provide that the tax upon this privilege, which was the subject of the tax, should be

measured by " the fair value of its capital stock " and that " in *estimating* the value of capital stock the surplus and undivided profits shall be *included.*" In thus framing the statute the House managers took a long step forward in seeking to reach not only the former values (as measured in the Revenue Act of October 22, 1914), but also the additional value just referred to above—and by this action in adopting a broader term, to give indisputable evidence that a broader standard of measurement was contemplated. In the form prepared by the House managers the Senate agreed (see conference report H. R. 16763, pp. 14 and 15), and in that form it passed into law.

As will be readily seen, this Senate amendment was a much more restricted and narrow provision than that finally adopted. It meant a narrower standard of measurement of the privilege to be taxed. As stated above, the conference adopted the broader and more general provision and omitted the words " used in any of the activities or functions of their business " as well as the provision which specifically included the investments of capital stock, surplus, and undivided profits in securities.

As this court decided in *United States* v. *St. Paul, M. & M. Ry. Co.,* 247 U. S. 310, reports of a congressional committee in charge of a bill subsequently enacted into law, and statements made by the committee chairman, may be resorted to in

order to throw light upon the construction of a statute. This principle was applied by the court in *Central Union Trust Co.* v. *Edwards,* 282 Fed. 1008, where the legislative discussion relied upon by the appellant in the instant case was being considered. The court said (p. 1010):

> After the Act of September 8, 1916, had received from the Commissioner of Internal Revenue the construction now contended for by the defendant, Congress enacted the Revenue Act of 1918 containing section 1000a in the same language as of section 407 of the Act of September 8, 1916, except that the rate was doubled and the deduction lowered. The Senate had amended the House bill so as to make the basis of the tax the amount of the net assets shown on the books as of the close of the preceding income tax year. This amendment was rejected by the House, and the Senate receded from it in conference. This is persuasive that the words "fair average value of the capital stock" were not thought by that Congress to be synonymous with the net worth of physical assets as shown by the corporate books.

When that case reached the Circuit Court of Appeals for the Second Circuit, the legislative discussion was again considered, and that court said (287 Fed. 324, 328):

> The remarks made by the "committee chairman in charge" of the bill (*United States* v. *St. Paul,* M. & M. Ry. Co., 247 U. S. 310, 318), are available in Con-

> gressional Record, Sixty-fourth Congress, first session, September 7, 1916, and they satisfy us that the act was passed with the intent of permitting, and indeed compelling, the assessor to consider, not only paid-in capital, surplus, and undivided profits, but earnings and market value of shares. Such a method of assessment necessarily implies for the words "capital stock" an enlarged meaning, which, if it does not connote the somewhat cynical view of the Wisconsin court, supra, certainly goes so far as to regard as "fair" an examination of "the entire potentiality of the corporation to profit by the exercise of its corporate franchise."

It is to be noted that in all the measures used by Congress in capital stock taxes, the property of the corporation has been used as the measure of the value of the privilege and not the property of the stockholders. More detailed reference will be made at a later point in this brief to the history of the Federal capital stock tax.

II

The meaning of the term "capital stock" as used in the section of the Revenue Act of 1918 here involved is best understood by a consideration of the legislative history of the act and the context of the provision in question.

The term "capital stock" is ambiguous only when used disassociated from its context. It has been used in so many different ways that of necessity the intent must be determined by the

object sought to be attained in its use. A glance at the law dictionaries will show the many different meanings that have attached to it. It has been held to mean " capital," " the authorized amount of capital," " the amount of capital subscribed," " *assets,*" " capital paid in," " property belonging to the corporations," according to the context, and it has been distinguished from each of these.

The courts have generally held that there are two kinds of capital stock—two separate, distinct properties:

First. Capital stock of the corporation; capital stock in the hands of the corporation; the ownership of the corporation in *its* capital stock; capital stock which is the property of the corporation and out of which shares are carved.

Second. Capital stock of the shareholders—the proprietary interest of the individual stockholder in shares of stock.

It is obvious that in order to ascertain the meaning of "capital stock" as used by Congress in the Revenue Act of 1918, reference must be had to the purpose of the taxing act, the context of the act itself, and the legislative history of the act evidencing the intent of Congress.

Before passing to the consideration of the specific taxing act in question we call attention to the fundamental purpose underlying taxing statutes—that a taxing statute is drafted with a view of securing as much revenue as possible. Bear-

ing this principle in mind, let us briefly review the history of federal tax legislation relating to taxation of corporations.

III

The history of federal legislation relating to the taxation of corporations shows a continuous tendency upon the part of Congress to extend the standard of measurement by which the amount of tax is determined, always with a view to augmenting the revenue to be derived from the taxation of corporations.

In 1895 this court decided the case of *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 439. It held that the statute of 1894 imposing a tax on the income derived from real estate and invested personal property, by virtue of the bare ownership of such property, was unconstitutional in that it was a direct tax without apportionment. A rehearing of this case was had and the Chief Justice, speaking for the court, summarized the effect of that discussion as follows (158 U. S. 601, 635):

> We have considered the act only in respect of the tax on income derived from real estate, and from invested personal property, and have *not* commented on so much of it as bears on gains or profits from business, *privileges*, or employments, in view of the instances in which taxation on business, privileges, or employments has assumed the guise *of an excise tax* and has been sustained as such.

It was made clear by the *Pollock case* and *Knowlton* v. *Moore* (178 U. S. 41, 80) that a tax

is a direct tax when imposed upon property solely by reason of its ownership, but that such a tax is not a direct tax when imposed on the use or employment of property. " Within the category of *indirect* taxation * * * is embraced a tax upon business done in a corporate capacity * * *." (*Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 150.)

(*a*) *Corporation Excise Tax Act of 1909.*

On August 5, 1909, Congress enacted the " Corporation Excise Tax Act " (36 Stat., c. 6, 11, 112-117). In section 38 it provided:

> SEC. 38. That every corporation * * * organized for profit and having a capital stock represented by shares * * * shall be subject to pay annually a *special excise* tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the *entire net income* * * * received by it *from all sources* during such year * * *. [Italics ours.]

The Act was upheld and discussed in an exhaustive manner by the Supreme Court in *Flint* v. *Stone Tracy Co., supra.* Speaking to the point just discussed, the court said (220 U. S. at 146, 147):

> This tax, it is expressly stated, is to be equivalent to one per centum of the entire net income * * * received from *all sources* during the year—this is the measure of the tax explicitly adopted by the

> statute. The income is not limited to such as is received from property used in the business, strictly speaking, but is expressly declared to be upon the entire net income * * *. In other words, the tax is imposed upon the doing of business of the character described, and the measure of the tax is to be the income * * * received *not only from property used in business* but from every source. This view of the measure of the tax is strengthened when we note that as to organizations under the laws of foreign countries the amount of net income * * * includes that received from business transacted *and capital invested* in the United States, the Territories, Alaska, and the District of Columbia. * * * The evident purpose is to secure a return of the entire income, with certain allowances and deductions which *do not suggest a restriction to income derived* from property actively engaged in the business.

It is apparent that this court has interpreted the intent of Congress to be liberal and broad with respect to elements constituting the value of the privilege taxed. This is further borne out by the language of the court in the same case at page 165, as follows:

> It is therefore well settled by the decisions of this court that when the sovereign authority has exercised the right to tax a legitimate subject of taxation as an exercise of a franchise or privilege, it is no objection

> that the measure of taxation is found in the income produced in part from property which of itself considered is nontaxable. * * * The measure of taxation being the income of the corporation from all sources, as that is but the measure of a privilege tax within the lawful authority of Congress to impose, it is no valid objection that this measure includes, in part at least, property which as such could not be directly taxed.

The court is here taking the broad view of the " measuring rod " by which the tax is determined. Consider the analogy between the contention in the above case and that in the instant case. Here the company has large and valuable assets whose value, because of their probable (or apparent) unproductiveness, or because they are not actively used in the business, are not necessarily reflected in the stock market as evidenced by the sales of stock. The appellant would contend, then, that these assets should not be considered in measuring the value of the capital stock. It is true it does not say it in that manner, but it comes to that inevitably, since appellant contends that only such sales on the market should be considered. These sales reflect the business done, income produced, dividends paid, and a thousand other nebulous influences which affect the market prices of stock as an earth tremor influences the seismograph. But as we have noted before, and supported by the language of the Supreme Court in the *Stone Tracy*

Company case, Congress is not so much concerned with the amount of business done as with the amount of property which it has to do business with. The latter measures the value of the privilege and the former does not. Stock market prices may be considered as one evidence of value, but they are at best uncertain. A stock may be active or inactive, and the corporation may believe in full publicity or as in the American Sugar Company in Mr. Havemeyer's days, it may believe in secrecy as to the details of its operations. The buying public may know all or it may know nothing. It may buy in the dark or in the daylight.

(b) Bankers Tax Act of October 22, 1914

As we have heretofore shown in the Bankers Tax Act, Congress used as a measure of the tax "capital used or employed." This standard is a broader one than that included in the "Corporation Excise Tax Act of 1909," and shows a tendency of Congress to include all elements that would tend to give the privilege value.

(c) Capital Stock Tax Act of September 8, 1916

We have heretofore shown the legislative history of the 1916 Act and have shown that Congress rejected the narrow measure of the tax included in the Senate amendment and adopted a much broader standard which is identical with the meas-

ure adopted in the Revenue Act of 1918 under consideration.

(d) Central Union Trust Co. v. *Edwards*

In the case of *Central Union Trust Company* v. *Edwards,* 287 Fed. 324, the Circuit Court of Appeals for the Second Circuit construed the 1916 Act as meaning that the "fair value of its capital stock" as used in that act included both tangible and intangible assets, such as good will, good management, and established capacity for earning profit. The legislative history of the Act was examined and held to contemplate as a measure of the tax "the entire potentiality of the corporation to profit by the exercise of its corporate franchise." The *Coleman case* and similar State decisions cited by appellant in this case were cited and cast aside as leading to "the belief that 'capital stock' is a term plastic, to say the least, and compelling its interpreter to look first to the context for a meaning that has not been reduced to any rigid formula." The court, in referring to the legislative history of the act, says (287 Fed. 328):

> The remarks made by the "committee chairman in charge" of the bill (*United States* v. *St. Paul, etc., Ry.*, 247 U. S. 310, 318) are available in Congressional Record, Sixty-fourth Congress, first session, September 7, 1916, and they satisfy us that the

act was passed with the intent of permitting, and indeed compelling, the assessor to consider not only paid-in capital, surplus, and undivided profits but earnings and market value of shares.

It should be noted that the court states that market value of shares should be considered, but that they are to be considered in connection with other information available, exactly as is being done in the instant case and not, as is here contended by appellant, taken as conclusive. The reasoning of the court is:

(*a*) This is admittedly an excise or privilege tax.

(*b*) Measured by property.

(1) Whose property? That of

(a) The corporation?

or

(b) Of its shareholders?

(*c*) To answer the above, reference must be had

(1) To the wording of the Act, if clear, and full scope given.

(a) Words as used are frequently short cuts (formulæ) for a permitted meaning.

(b) Is phrase "capital stock" so used in the Act?

(1) No generally accepted meaning.

(2) No authority limiting Congress in any meaning it might place upon phrase.

(3) State courts show a wide diversity of opinion.

(c) Since (b) proves term is plastic, look at context.

(1) "Fair value."

(2) "Estimating fair average value."

Both show book values not intended.

(d) Look at legislative history.

(1) Shows plainly that an enlarged meaning was placed on phrase by Congress, that "fair" means an examination of "the entire potentiality of the corporation to profit by the exercise of its corporate franchise."

(e) *Comparison of the above Acts of 1916 and 1918.*

Section 407 of the Revenue Act of 1916.	*Section 1000 of the Revenue Act of 1918.*
"Every corporation, joint stock company or association, now or hereafter organized in the United States for profit and having a *capital stock* represented by shares * * * shall pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to fifty cents for each $1,000 *of the fair value of its capital stock* and in estimating the value of capital stock the surplus and undivided profits shall be included * * *. The amount of such annual tax shall in all cases be computed on the basis of the *fair average value* of the capital stock for the preceding year * * *."	"Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business equivalent to $1 for each $1,000 of so much *of the fair average value of its capital stock* for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included."

The case of *Central Union Trust Company of New York* v. *Edwards, supra,* deciding the meaning of capital stock as used in the 1916 Act is an authority for the same meaning for the 1918 Act since the Acts are substantially identical.

(f) *Regulations under the Revenue Act of 1918 were adopted by the Revenue Act of 1921*

Regulations No. 50, promulgated by the Secretary of the Treasury on May 25, 1920, provides in part as follows:

> ART. 14. *Fair average value of capital stock.*—The fair average value of the capital stock for the purpose of determining the

amount of the capital stock tax must not be confused with the market value of the shares of stock where it may be necessary to determine such value under other provisions of the revenue laws. The fair average value of the capital stock, the statutory basis of the tax, is not necessarily the book value or the value based on prices realized in current sales of shares of stock or even the value, determined by capitalization of earnings, although it may be more directly dependent upon the last. It should usually be capable of appraisal by officers of the corporation having a special knowledge of the affairs of the corporation and general knowledge of the line of business in which it is engaged. Provision is accordingly made in Exhibit C of Form 707 (Revised) for the tentative determination of the fair value of the capital stock by capitalizing the net earnings of the corporation on a percentage basis fixed by its officers as fairly representing the conditions obtaining in the trade and in the locality. But such fair value, except in the case of insurance companies, must not be set at a sum less than the reconstructed book value shown by Exhibit A, unless the corporation is materially affected by extraordinary conditions which support a lower valuation. In any such case a full explanation must accompany the return. The commissioner will estimate the fair value of the capital stock in cases regarded as involving any understatement or undervaluation. * * *

A consideration of this regulation shows that the ruling therein is consistent in every particular with the intent of Congress as outlined in the Revenue Act of 1918.

It is firmly established that regulations, duly promulgated under statutory authority, have the force and effect of law, and, where an interpretation and construction of a statute by an executive department has been long continued and the law uniformly administered, regulations are given great weight by the courts. As was said by this Court in the recent case of *Maryland Casualty Company* v. *United States,* 251 U. S. 342, at page 349:

> * * * It is settled by many recent decisions of this court that a regulation by a department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. *United States* v. *Grimaud,* 220 U. S. 506; *United States* v. *Birdsall,* 233 U. S. 223, 231; *United States* v. *Smull,* 236 U. S. 405, 409, 411; *United States* v. *Morehead,* 243 U. S. 607. * * *

The same principle is further supported by *United States* v. *Eliason,* 16 Pet. 291; *Gratiot* v. *United States,* 4 How. 80, 117; *Ex Parte Reed,* 100 U. S. 13, 23; *United States* v. *Eaton,* 144 U S. 677, 688; *In re Huttman,* 70 Fed. 699, 701.

It is a well-settled principle of law that the reenactment by Congress without change of a

statute which had previously received executive construction is an adoption by Congress of such construction. *United States* v. *Falk*, 204 U. S. 143; *United States* v. *Hermanos y Compania*, 209 U. S. 337.

Congress has reenacted in the Revenue Act of 1921 a capital stock tax based upon the "fair average value of the capital stock," and under the principle of these cases it must follow that it has adopted the construction consistently placed upon this language by the Commissioner of Internal Revenue. Therefore if plaintiff should make the same claim under the 1921 Act that it is now making under the 1918 Act it must inevitably be defeated, since the intention of Congress can no longer be doubted. No better evidence could be found that, by the use of these words in the Revenue Acts of 1916 and 1918, Congress did not intend anything different.

IV

The context of the provision shows that Congress has used as the measure of the tax the property of the corporation and not the property of its shareholders.

(*a*) *"Its capital stock"*

Having already noted that in previous acts Congress has used as the measure of the tax the property of the corporation and not of its shareholders, it will be seen in enacting the Revenue Act of 1918 Congress did not intend to change the measure to

the property of a person not being taxed. The distinction between the two kinds of capital stock, referred to hereinabove, should be carefully borne in mind. If there are two kinds of property, logically both the corporation and the stockholder may be taxed. Where, for example, the capital stock of a bank is exempted from taxation, nevertheless the property of the stockholders in shares of stock may be taxed. (*Albany City National Bank* v. *Maher,* 6 Fed. 417.) Since good will, franchises, and the like, *although intangible, are valuable assets,* a property tax on the "capital stock" of corporations has been in the favored means used by States to reach this kind of property. In such cases, that which is sought to be reached is the *property of the corporation,* and the term "capital stock," used in statutes of this character, refers to the capital stock in the hands of the corporation and *not* to the proprietary interest in shares of stock. Thus we see that "capital stock" in this sense refers to *all* property of the corporation—both tangible and intangible. In such cases it is customary for the statute to impose a tax on the value of the capital stock (*including* franchises, good will, and intangibles) over and above, or in excess of, the assessed value of real estate and tangibles. (See *Chicago Union Traction Co.* v. *State Board of Equalization,* 112 Fed. 607.) Thus, where a statute sought ostensibly to tax a national bank on "*shares of stock*" in the hands of its share-

holders, and it appeared that what was really sought to be reached was the property of the bank, it was held that the tax was on the bank's interest in *its* capital stock and not in fact on the shares of stock in the hands of shareholders. (*Home Savings Bank* v. *Des Moines*, 205 U. S. 503.)

(b) "Estimating"

Congress used the words "in estimating the value of capital stock and disclosing an intention that all factors and elements should be considered in estimating the *fair average value.*" This point is illustrated by the language used by this court in referring to a taxing statute of Michigan. Mr. Justice Brewer, speaking for the court, said (*Powers* v. *Detroit & Grand Haven Ry. Co.*, 201 U. S. 543, 561):

> Again, the tax is to "be estimated upon the last annual report of the * * * corporation." While such report might be expected to include not merely the property belonging to the corporation but also the number and names of the stockholders and the number of shares held by each, and possibly also the amount paid in by each, yet the word "estimated" carries with it the idea of valuation rather than of mathematical apportionment. It suggests that the property reported by the corporation is to be the basis upon which the assessors shall make their valuation, so that the tax is "estimated" upon that property rather than

> fixed by the mere process of multiplication or division. * * * Under those circumstances we are of opinion that the tax provided for by section 9 is a tax upon the property of the corporation and not a tax upon the shares of stock held by the shareholders.

(c) "Surplus and undivided profits shall be included"

In estimating the value of capital stock, "surplus and undivided profits *shall be included.*" In other words, Congress has in effect said that the value of the privilege of doing business and the measure of the tax is the value of tools, assets, franchise, good will, etc.—the capital stock—which is employed in doing business—the potential value of privilege, not the gain derived from the privilege. Why include "surplus and undivided profits" if we are concerned only in the earnings and not in the value of that with which the corporation has to do business. Under section 3 of the Act of October 22, 1914, the value of the privilege of doing a banking business was the amount of capital employed or used in the business irrespective of whether the business was profitable or otherwise. The present capital stock tax laws exhibit no intent to use a lesser measure. There is nothing in the capital stock tax acts which infers that only profitable businesses are to pay the tax. If the privilege of doing business is not worth the net assets of the corporation, either for present or future gain, why keep the corporation alive—why not liquidate?

By liquidating, a value equivalent to the liquidating value of the net assets may be gotten out of the stock.

(d) "Fair average value"

The Revenue Act of 1918 was enacted February 24, 1919, and made no substantial change from the language of the Revenue Act of 1916. The new law imposed the tax on "*every* domestic corporation," omitting the words "having a capital stock represented by shares." It also added the word "average" to "fair value," making the new law read "fair average value of its capital stock." There was no change in the basis of the tax.

> On amendment No. 488: The House bill imposed upon a domestic corporation an annual excise tax equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year as is in excess of $5,000. It also provided that in estimating the value of the capital stock the surplus and undivided profits should be included. ***This is the basis of the tax under the present*** (1916) ***law,*** with the rate increased 100 per cent. The Senate amendment changes the basis of the tax from the fair average value of the capital stock to the amount of the net assets shown on the books as of the close of the preceding income-tax year; and the Senate recedes. (Conference Report No. 1037, to accompany H. R. 12863, p. 84; 65th Cong., 3d sess.)

It is plainly to be seen from the foregoing that whatever Congress intended by the words " fair

value " and " fair average value of the capital stock " it did *not* intend the *par value* of the stock, nor the book value of the *tangible assets,* nor the amount of capital subscribed and paid in, nor the amount of capital stock liability charged upon its books, nor anything else which is *fixed and determined.* The history of the legislation shows that Congress was insistent upon arriving at a standard of measurement which would be broad and comprehensive enough to cover any and all factors or elements which might enter into the valuation of the *privilege to the corporation* in carrying on or doing business in a corporate capacity. Thus Congress was intending to estimate the *potential value* of such a privilege to the corporation—*rather than the actual use made of its privilege by the corporation in so carrying on its business.* The word "fair " shows that Congress did not have in mind any particular method of value, like the corporate balance sheet, or sales on the market of a comparatively small per cent of the shares of stock, but intended a valuation in which the several factors would be taken into consideration in arriving at an equitable result. The word " average " shows that it did not intend something fixed and determined like par value of stock, book value of assets, or liquidating value, but had in mind the value of the corporate business as a going concern, which must naturally fluctuate, and which would therefore be subject to estimation, appraisal, or average.

(*e*) *Provisions of the Revenue Act of 1918 as to foreign corporations*

Section 1000 (a) (2) of Title X of the Revenue Act of 1918 provides:

> Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the *average amount of capital employed in the transaction of its business* in the United States during the preceding year ending June thirtieth. [Italics ours.]

The Senate amendment provided with respect to domestic corporations that the valuation should be the book value of the assets at the close of the preceding year, yet used the phrase "capital employed" with reference to foreign corporations. In its final form as enacted the Senate standard as to domestic corporations was rejected but the measure as to foreign corporations was accepted.

(*f*) *The measure adopted for mutual insurance companies*

That Congress could not have meant shares of stock when it said "capital stock" is further evidenced by the context of the Revenue Act of 1916, which used the same phrase. Section 407 states the persons liable for the tax as follows (39 Stat. 789):

> Every corporation, joint stock company or association * * * having a capital stock

represented by shares, *and every insurance company* * * *, etc.

Then follows the measure of the tax, based on "the fair value of its capital stock."

It is obvious that under the phrase "every insurance company" must be included the mutual companies, which have no shares of stock. Yet the measure is the same for them as for corporations "having a capital stock represented by shares"—that is, "the fair value of its capital stock." Since Congress used the same measure for two kinds of corporations, one having shares of stock, the other having none, it must be certain that Congress did not intend share valuation as the exclusive measure.

V

The history of federal capital stock taxes and the context of the Act of 1918 show that Congress intended to include all factors of value.

The appellant takes the position that it is the *shares* of stock and *not* the assets which are to be valued as a measure of the tax, and it further insists that where there are sales of such shares on the market that such sales should be conclusive and form the basis of the measure of the tax.

We have attempted in this brief to show that the statute has no such narrow meaning; that in the first place it is not the shares of stock which are to be valued, since that is a property entirely distinct and apart from the property of the corporation. Again we have called attention to the language of

the statute showing that it is the *capital stock of the corporation*—" the fair average value of *its* capital stock " which is under consideration, and that since the stockholders are not taxed their shares are not the measure.

We have attempted to show—and we believe we have demonstrated—that Congress intended to reach a fair valuation of the privilege of doing business, and in measuring the tax by the capital stock of the corporation it was meant that the valuation so placed on the capital stock should reflect in every possible way the value of this privilege of doing business.

We do not deem it necessary to argue at any length to this court that there are numberless influences which affect the market price of stocks and which bear absolutely no relation to the real value of the privilege enjoyed by the corporation in carrying on its business. It is readily conceivable that a conservative concern which turns its earnings back into the business in the purchase of valuable properties—or properties which may become valuable in the future pursuit of its business—and pays no dividends (or negligible ones), may see its stock go to a very low level because the investing public is not interested, as a rule, in the purchase of nondividend bearing stock. And yet, although its stock may be selling at a nominal figure in the market, the company may be earning tremendous amounts—the result of which will at a

future date be apparent. Now it is fallacious to say that the privilege enjoyed by the corporation, in thus doing its business and amassing great properties for future earnings, is to be measured by the nominal sales of its stock. Without doubt the court will recall numerous instances of such situations. And again, the results of propaganda, or the activities of persons of bearish or bullish tendencies may (and do) have a powerful influence in holding down or pushing up the market when it suits the ends of those behind such endeavors. It is well known that the heavy selling of a stock will often have a pronounced tendency to drive the market down—and yet the inherent value of the corporation's "capital stock," in the sense we have shown it to be intended, is not in the least affected thereby. Take a corporation which is conservatively building for the future, and with great schemes of operation under way which absorb all of its present earnings—the privilege such a corporation enjoys is as great as, and perhaps greater than, the privilege enjoyed by another and less conservative concern which distributes its earnings in dividends as fast as they are earned and thus forces the price of stock to a high level on the market, and operates purely upon the expectancy of good business conditions. This second corporation could not be said to have a capital stock as valuable on a fair estimation of value as a whole as the one first above mentioned, in spite of the fact that the sales of its stock would indicate

and, according to plaintiff's contention, *would prove conclusively* that it was the more valuable of the two. We do not believe it is necessary to pursue this line of reasoning further, for the case is a patent one that such a criterion would be an absurd one as well as unconscionable.

Acting upon the intention of Congress as disclosed by the Congressional Record, the authority of the courts, State and Federal, in construing similar statutes, and the considerations outlined above, the Commissioner of Internal Revenue in enforcing the provisions of the Act in question has adopted the view that "fair value of the capital stock" meant neither par value of stock outstanding nor book value of assets over and above liabilities, *but the value of the corporate business as a going concern,* the value of all the property of the corporation, tangible and intangible, its franchises, its business opportunities, capacities, and prospects viewed as an entirety. By "fair average value" the Commissioner has ruled that Congress intended that several factors, besides book value, should be taken into consideration, and that such corporation should receive individual treatment, and that no hard and fast test of "fair average value," applicable to all companies without discrimination, should be adopted.

VI

The burden is on the taxpayer to establish by a preponderance of the evidence all the facts necessary to show that it does not owe to the Government the tax which it is seeking to recover by this action.

The appellant contends that the proper method of determining the tax is by a valuation disclosed by sales of share stock on the market. If it were to be admitted that such a method is a proper one, the claimant is not entitled to a verdict. The burden is upon it to prove by a preponderance of the evidence (1) that the method used by the Commissioner of Internal Revenue is entirely erroneous and improper and fundamentally wrong; (2) that the method contended for by it is the fundamentally proper method to the exclusion of any method used by the commissioner.

The Commissioner of Internal Revenue in making assessment of taxes acts in a quasi-judicial capacity, and his findings as to valuation are not judicially reexaminable unless resulting from some principle of assessment which is *fundamentally* wrong. When a discretionary authority is conferred upon a public officer, and he is made judge of the facts, his decision in the absence of any qualifying or controlling statutory restrictions upon the effect of his decision is conclusive. (*Allen* v. *Blunt,* Fed. Cas. 217.)

In *Louisville & Nashville R. R. Co.* v. *Greene,* 244 U. S. 522, 536, this court said:

> The findings of an official body such as the board of valuation and assessment, made * * * after a hearing and upon notice to the taxpayer, are *quasi* judicial in their character, and are not to be set aside or disregarded by the courts unless it is made to appear that the body proceeded upon an erroneous principle or adopted an improper mode of estimating the value of the franchise, or unless fraud appears.

At the same term and in a similar case the court said that in the absence of fraud the valuations made by an assessing board are not judicially reexaminable unless resulting from some principle of assessment which is *fundamentally* wrong; *Illinois Central R. R. Co.* v. *Greene,* 244 U. S. 555, 562.

To the same effect are: *Park Falls Lumber Co.* v. *Burlingame,* 1 F. (2d) 855, where the rule was recognized in a case involving the section of the Act of 1918 which is involved in the instant case; and *Dugan* v. *United States,* 34 Ct. of Claims, 458, 466; *Anderson* v. *Farmers' Loan & Trust Co.,* 241 Fed. 322, 329; *Germantown Tr. Co.* v. *Lederer,* 263 Fed. 672, 676; *New York Life Insurance Co.* v. *Anderson,* 263 Fed. 527; *Schmitt* v. *Trowbridge,* Fed. Cas. 12468.

Where the validity of an assessment is attacked, it has been universally held that when the determination of the amount of the tax due is made by

the Commissioner of Internal Revenue, such determination is *prima facie* valid and the person who attacks it has the whole burden of proving *that such tax is not due.* In the instant case this would necessitate proof on the part of the plaintiff that not only is the method contended for by it a correct method, but must also show that it is the only correct method or that the method adopted for the valuation by the commissioner is based upon a principle which is not only erroneous but fundamentally wrong.

The leading case on this subject is that of *United States* v. *Rindskopf,* 105 U. S. 418. In that case this court sustained a portion of the charge of the lower court to the jury as follows (p. 420):

> When, therefore, an assessment has been made by this officer, it is to be presumed, until such presumption is overcome by proof to the contrary, that it was made upon sufficient evidence, and it is not necessary that the evidence upon which the commissioner acted should be laid before the jury.

The *Rindskopf case* was followed by the Circuit Court of Appeals for the Eighth Circuit in the case of *Western Express Co.* v. *United States,* 141 Fed. 28. There the court said (p. 30):

> The controlling question, therefore, for decision is whether or not there was any evidence in the case to support the finding. If there was, the verdict must stand. The action being based upon assessments made by the proper revenue officers of the Govern-

> ment, the law presumes that these officers proceeded regularly; that on due inquiry they ascertained the existence of the essential facts subjecting the defendant to such tax. In this respect such officers act in a quasi-judicial capacity, and their action stands as prima facie correct until this presumption, by countervailing proof, is met and overthrown by the party assessed.

To the same effect is the decision in *United States* v. *Cole,* 134 Fed. 697, 700, where the Circuit Court for the Middle District of Tennessee said:

> * * * Furthermore, I may repeat and restate that the burden is not on the Government in the first instance to go behind the assessment made and certified, and to show either directly or circumstantially the actual production of spirits in order to uphold the assessment. As I have pointed out, the assessment is prima facie valid, and sufficient to support judgment for the Government unless the defendant *is able to show its invalidity.* [Italics ours.]

This statement of the court supports our proposition made above, that it is necessary that plaintiff prove the *invalidity of the assessment* in the instant case, and that a mere showing of the correctness of his own method is not sufficient to support its action. This is further borne out by *Germantown Trust Co.* v. *Lederer,* 263 Fed. 672, 676:

> The decision of an assessor must stand until it can be affirmatively controverted.

> One attacking his assessment *has the burden of showing it is unlawful.* [Italics ours.]

Mr. Justice Hunt, in *Arthur* v. *Unkart,* 96 U. S. 118, at page 122, said:

> These officers are, however, selected by law for the express purpose of deciding these questions; they are appointed and required to pronounce a judgment in each case; and the conduct, management, and operation of the revenue system seem to require that their decisions should carry with them the presumption of correctness. This rule is not only wise and prudent, but it is in accordance with the general principles of law that an officer acting in the discharge of his duty, upon the subject over which jurisdiction is given him, is presumed to have acted rightly.

In the case of *Canal & Banking Co.* v. *New Orleans,* 99 U. S. 97, 99, the court said:

> In this suit the burden of proof is on the bank to show *that it has been unlawfully taxed.* [Italics ours.]

The cases to this effect could be multiplied without adding to the force of the well-settled doctrine. Attention, however, is called to *Schafer* v. *Craft,* 144 Fed. 907; *Schmitt* v. *Trowbridge,* Fed. Cas. 12,468; *Malley* v. *Walter Baker & Co.,* 281 Fed. 41; *Dodge* v. *Osborn,* 240 U. S. 118; *Clinkenbeard* v. *United States,* 21 Wall. 65.

VII

Conclusion

In measuring the tax by the fair average value of the capital stock all factors which enter into the value of the privilege taxed may be considered. The Government is not confined, in this determination, to the market value of the share stock as an indication of such value. The Exhibits A, B, and C on the tax returns are all for the benefit of the commissioner in helping him to arrive at a proper estimate. No one of them is necessarily controlling. In his quasi-judicial capacity the commissioner is the judge of the probative values to be given to each. This is within his prerogative and can not be attacked except for fraud or by a showing that the assessment is illegal and unlawful upon principle. Therefore, unless the appellant can prove that the assessment is illegal, unlawful, and based upon an erroneous principle which is in itself fundamentally wrong, it will not avail him to prove that a correct way to value the capital stock of a corporation is by averaging the market sales of its share stock held by individual shareholders. To prove this would only be to prove what the Government already admits, to wit, that under some circumstances such a method might be proper. But the Government does not admit that it is the only method that is correct. It is simply an element or factor to be taken into consideration together

with other elements and factors in determining, by elimination, the fair average value of the company's privilege of doing business in a corporate capacity measured by *its* capital stock.

The case of *Central Union Trust Company of New York* v. *Edwards,* 287 Fed. 324 is conclusively against the method of valuation contended for by the appellant in this case and controls this case. The appeal should be dismissed.

JAMES M. BECK,
Solicitor General.

ROBERT P. REEDER,
FRED K. DYAR,
Special Assistants to the Attorney General.

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